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IN THE

Supreme Court of the United States

October Term, 1970

No. ~~1640~~ 70-136

F. D. RICH COMPANY, INCORPORATED,
a corporation doing business in the state of Washington
and AMERICAN SURETY COMPANY,
Petitioners,

v.

ACME GRANITE & TITLE COMPANY, a Division of Piper & Greenhalgh, Incorporated, a Washington corporation; B & G CONSTRUCTORS, INCORPORATED; FIREMAN'S FUND INSURANCE COMPANY; and UNITED STATES FIDELITY & GUARANTY COMPANY;
Respondents.

BRIEF OF FIREMAN'S FUND INSURANCE COMPANY IN OPPOSITION TO PETITION FOR CERTIORARI

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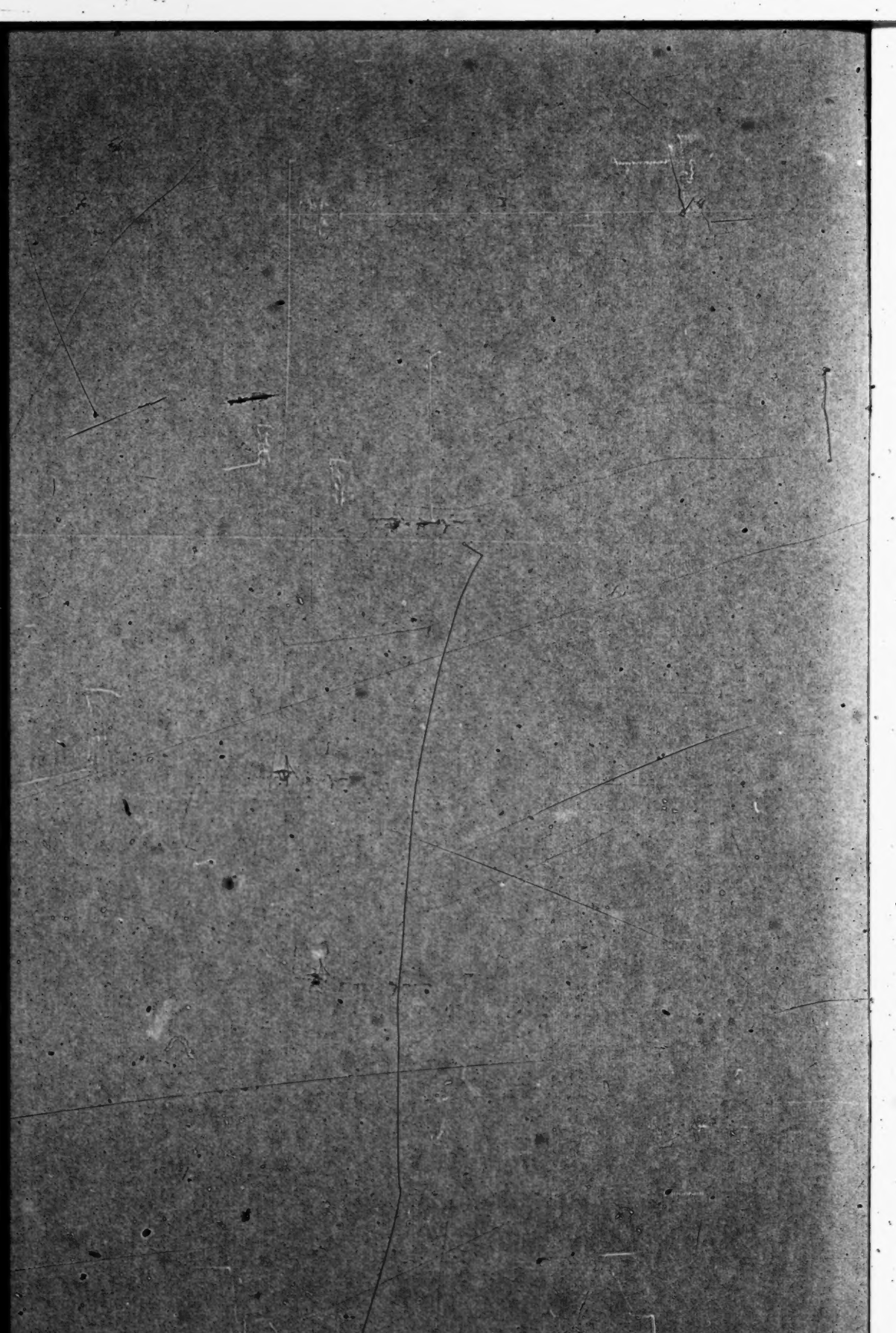

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DECISION BELOW WAS NOT CONTRARY TO WASHINGTON LAW

In this case the surety, Fireman's Fund Insurance Company, was always a viable party in this case, and whatever may have been the situation with respect to the corporation, Acme Granite & Title Company, the surety company was entitled to assert all offsets and receive the benefits of debts due the former corporation from F. D. Rich Co., Inc. The federal rule expressly contemplates the substitution of

one having standing in court for one who lacks it (Fed. Rule 25C).

When the trial court abated the action entirely because of the dissolution of the principal, it left the surety exposed to claims for which there were valid defenses by way of offsets and counterclaims.

This result is not required by any technical rules with respect to abatements of actions.

The surety company was entitled to have adjudicated the claim of Acme Granite & Tile Co. as an offset against any judgment that might be awarded against it in favor of defendant Rich.

The trial court was seriously in error in abating the action altogether.

The dissolution of a coporation, under Washington law, does not cancel a chose in action which existed in its favor prior to dissolution. This became one of the assets of the corporation, which passed by operation of law to its shareholders and was a trust fund for its creditors.

The Washington Supreme Court so held in the case of *Soderberg v. McRae*, 70 Wash. 235, 239, 126 Pac. 538, where the court said, on page 239:

> ". . . Under Rem. & Bal. Code, §3715d, upon the dissolution of a corporation, its trustees hold its property for the benefit of its stockholders and creditors. Under this statute, we have no doubt the trustees could maintain proceedings to acquire such possession. The only trustee of this corporation who is now a stockholder, or was at the time of its dissolution, is Soderberg. Under these circumstances, we find no objection to the power of the court to enter the decree appealed from."

In that case the court permitted the successor to the property of a dissolved corporation to maintain an action. It is true that the court there referred to an old statute, but substantially the same rule is still in effect in Washington and the same rule still applies with the former stockholders substituted for the last trustees. The Washington Business Corporation Act which was in effect at the time that the order abating the action was entered, provided in RCW 23.01.560:

> "Any surplus remaining after paying or adequately providing for all debts and liabilities of the corporation shall be distributed either in cash or in kind to the trustee or trustees of the shareholders according to their respective rights and preferences."

This section has been interpreted by the Supreme Court of Washington in the case of *Ban-Mac, Inc. v. King County,* 69 Wn.2d 49, 416 P.2d 694, as being merely a statutory enactment of the common law rule that upon the dissolution of a corporation its assets *automatically* pass to its shareholders, saying:

> ". . . it was a transfer pursuant to the established principle of corporate law that ownership of corporate stock carried with it the inherent right to share in the distribution of surplus corporate assets remaining on hand after discharge of corporate liabilities and expenses of dissolution.
>
> "As stated in 19 C.J.S., *Corporations,* §1730, page 1489 (1940), 'In the absence of statute, the legal title to property belonging to the corporation passes by operation of law to the stockholders, who are the beneficial owners through the corporation, and who take as tenants in common . . .'
>
> "R.C.W. 23.01.560 is merely a statutory enactment of that rule. It provides in part: 'Any surplus remaining after paying or adequately providing for all debts

and liabilities of the corporation shall be distributed, either in cash or in kind, by the trustee or trustees to the shareholders according to their respective rights and preferences.'

"We have applied this construction of the statutes subsequently to *Deer Park, supra,* in *Doric Co. v. King Cy.*, 66 Wn.2d 76, 401 P.2d 332 (1965)."

In the case just cited the matter of the transfer upon dissolution to the stockholders was held to be automatic. Such a transfer by operation of law occurred in this case and there always was a successor party capable of maintaining the action.

In this case a motion was made to substitute the former stockholders who were entitled to the assets of the corporation and the court denied it. This motion should have been granted. These former stockholders were the actual owners of the *chose in action* and it was *property which was not destroyed by the dissolution.*

In a case somewhat analogous to this, *Brown v. Keller,* 274 F.2d 779, the Sixth Circuit Court of Appeals ruled that an action which was pending by persons in their capacity as trustees who after commencement ceased to have such capacity could nevertheless proceed where there was another person having capacity to sue in a representative capacity who could have been added to the cause. Such was the case here. Mr. Piper and Mr. Greenhalgh should have been substituted and the action should have proceeded. Such a substitution was absolutely necessary to protect the rights of the parties, *particularly the surety,* which by the action of the court was left without the protection that would have occurred from the offset available to the plaintiff had it prevailed in the action.

Under the law of Washington, when a corporation is

dissolved by operation of the law, its property and assets go to its stockholders who then hold these assets as tenants in common. In the case of *Brower Company v. Noise Control of Seattle,* 66 Wn.2d 204, 401 P.2d 860, the Washington Supreme Court quoted with approval the language of Federal District Judge Netterer in *Denman v. Richardson,* 284 Fed. 592, as follows:

> "By the same token, upon the dissolution of a corporation, the trustees at the time of the dissolution shall be the trustees of the creditors and stockholders and shall have full power and authority to sue for and recover the debts and property of the corporation. Upon dissolution of the corporation the corporate entity ceased. The corporation has no power to sue. All rights of the corporation are ended and the property and funds of the corporation are vested in the trustees for the stockholders."

In this comparatively recent case the Washington Supreme Court has recognized the successor nature of the individuals who succeed to the property of the corporation when it is dissolved.

In the present case, when the corporation was dissolved its stockholders succeeded to ownership in kind of its property, including the chose in action against F. D. Rich Co., Inc. As successors they fell directly within Rule 25C of the Federal Rules. *Moore's Federal Practice,* second edition, Volume 4, page 526, says of such a situation:

> "Since substitution does not effect the substantive rights involved in a transfer of interest, it may under some circumstances be unnecessary; indeed, the court may in the exercise of its discretion find it more convenient that the original party who in this situation is still able to continue the action do so. In such a case a transferee will be bound by the judgment even though not a party for his rights are no better than the transferors; and similarly if the judgment is in favor of the

transferor the adjudication enures to the benefit of the transferee . . ."

In the present case the substitution of the transferees who acquired the chose in action by operation of law should have been made by the trial judge and we submit that it was an abuse of discretion for the trial judge to have refused to do this. The refusal of the trial judge to make this substitution was highly prejudicial to the surety and could not in any way have resulted in any disadvantage to the defendant F. D. Rich Co., Inc.

Property is not abolished by the dissolution of a corporation and a chose in action is such property and belonged to someone. By the law of Washington, the remaining stockholders are the transferees and they should have been substituted for the dissolved corporation.

Petitioners in this case are incorrect when they say that the court below acted contrary to the Washington law. The Washington law does contemplate that the assets of the corporation remain alive and are a *trust fund* for its creditors and stockholders.

Actually, in this case the surety company was always in the action and was a party capable of asserting for its own benefit all setoffs available by way of any action against F. D. Rich Co., Inc.

The surety, Fireman's Fund Insurance Company, is a creditor of Acme Granite & Title Co. to the extent that it has any liability in this case. Under the law of Washington, the assets of a dissolved corporation are a *trust fund* for the creditors and when they pass to the stockholders upon dissolution they are impressed with that trust. In *Taylor v. Interstate Investment Company*, 75 Wash. 490,

135 Pac. 24, the Washington Supreme Court said on page 496:

> "The dissolution of these corporations is immaterial since whatever property rights they had would pass on such dissolution to their stockholders subject to corporate liabilities. 3 Purdy's Beach, Private Corporations 1323."

Debts due to the corporation are property which passed to the shareholders upon dissolution. Dissolution of the corporation had no effect upon the continued existence of its chose in action against defendant F. D. Rich Co., Inc. That property right continued and the only problem presented by dissolution was *whether there was a party* capable of carrying on the action.

When F. D. Rich Co., Inc. in their petition (Pet. 8), cite such cases as *State ex rel. National Surety Co. v. Superior Court,* 180 Wash. 587 and *Columbia Building Co. v. National Surety Co.,* 194 Wash. 51, for the proposition that a dissolution abates an action, their authority goes only to the proposition that the *dissolved corporation* may not continue to maintain the action. Those cases do not hold that the property rights of the corporation die with the the dissolution or that its liabilities and assets die with it. On the contrary, *Columbia Building Co. v. National Surety Co.,* 194 Wash. 51, 76 P.2d 1027, is express authority for the survival of an action involving a dissolved corporation through the substitution of the one into whose hands the assets of the corporation passsed. In that case the assets of the corporation had been transferred to the state insurance commissioner and the court there specifically approved the substitution of the insurance commissioner for the corporation.

In the present case, while the corporation could not continue to function, there is no reason at all why its former stockholders to whom all of its assets had passed by operation of law, could not be substituted.

Since Fireman's Fund Insurance Company was a creditor whose interests were to be protected, it, as a party to the action, had a standing in the case and was entitled to assert all offsets and receive the benefit of debts due the former corporation from F. D. Rich Co., Inc. The federal rules expressly contemplate the substitution of one having standing in court for one who lacks it (Fed. Rule 25C).

The dissolution of this corporation did not, as the trial judge seemed to imply, give it an escape from it liabilities for the law in Washington is quite to the contrary. In *Mayflower Realty Co. v. Security Savings & Loan Society*, 192 Wash. 129, 72 P.2d 1038, the Washington Supreme Court said:

> "It is well settled that, if the dissolution of a corporation is voluntary and it elects to take advantage of the option given it by law to terminate the existence of the corporation, the dissolution is due to its acts and the corporation remains liable upon its outstanding executory contracts. 5 Page on Contracts 4736, §2691; 5 Page on Contracts 5135, §2912; 2 Page on Contracts 1929, 1998, §2912; *Tiffin Glass Co. v. Stoehr*, 54 Ohio St. 157, 43 N. E. 279; *Suter v. Farmers' Fertilizer Co.*, 100 Ohio St. 403, 126 N. E. 304."

The dissolution in this case actually had no effect except to require the substitution of one having a standing to maintain the action. In the case of *State ex rel. Everett Trust & Savings Bank v. Pacific Waxed Paper Co.*, 22 Wn.2d 844, 157 P.2d 707, the Washington Supreme Court said:

> ". . . The rule seems to be that, when a corporation

is dissolved by its voluntary act, the corporation remains bound by its outstanding executory contracts. *Mayflower Realty v. Security Savings & Loan Society*, 192 Wash. 129, 72 P.2d 1038; 75 P.2d 579."

Under the Washington rule that the stockholders got the property of the corporation subject to its liabilities, the debts due the corporation were not extinguished and the obligation of F. D. Rich Co. to the corporation continued and the stockholders as trustees for the creditors should have been permitted to substitute for the corporation to avoid a creation of an injustice by a strict application of a legal fiction. The rule is well established that where the trust fund theory applies, obligations due to the corporation are not extinguished by its dissolution. The text of 47 ALR 1355 states the rule:

"So far as the American states are concerned, the common-law rules explained in the preceding sections have been abolished, as a necessary result of the operation of what is commonly described as the 'trust fund doctrine.' It nature and scope are indicated by the following statements:

" 'When a business corporation, instituted for the purposes of gain or private interest, is dissolved, the modern doctrine is that its property, after payment of its debts, equitably belongs to its stockholders.

" 'The dissolution of a corporation cannot deprive its creditors or stockholders of their rights in its property; and if the common law affords them no adequate remedy, they may obtain relief in equity.

" 'Under the modern rule of equity jurisprudence, the severity of the common law in this respect is greatly mitigated, and it is held that it is the franchise, and not the property of the corporation, that is forfeited by a judgment of ouster, and that the property of the corporation is a trust fund for the payment of debts and distribution among stockholders.

> "'Nothing is better settled than that the assets of an insolvent corporation are a fund for the payment of its debts. The holders of such property take it charged with a trust in favor of such creditors, which a court of equity will enforce. A court, which *never allows a trust to fail for want of a trustee, will see to the execution of that trust, although by the dissolution of the corporation the legal title to its property has been changed.*'" (Emphasis supplied)

It will be noted from the foregoing quotation that the rule is well established that under the trust fund theory, the trust will not be allowed to fail for want of a trustee.

Applying that doctrine to the present case, Fireman's Fund Insurance Company is a creditor of Acme Granite & Tile Co., its principal, since the principal has an obligation to indemnify it from any losses which it may sustain by reason of its suretyship in this case. As such creditor, it has a right to insist upon the trust impressed upon the assets of the corporation when they passed into the hands of the stockholders being made available to satisfy the obligation of the corporation to it. The surety in this case not only had a right to have the stockholders of the corporation substituted as parties so that they might realize on the asset of the chose in action against F. D. Rich Co., but *the surety itself was a party to the action and as such a party had a standing in court and the right to assert the offset against any claim of F. D. Rich Co.* without being barred from such right by the dissolution of the corporation.

It was error for the court to prejudice the surety by abating the action of the principal and thereby leaving the surety without this offset which would have completely extinguished the liability.

The Circuit Court was correct in holding that the District Court had ample discretionary powers to substitute parties plaintiff where a corporate dissolution or some other act affecting the capacity to sue has occurred during the pendency of the action. In the absence of such a power, the property rights involved in the litigation would simply disappear, as would be the case here, where the surety would be left without the shield of the very substantial offset. The statement in the petition for certiorari that there was no action in which the substitution could be made is simply not correct. Fireman's Fund Insurance Company was always a party and always had the right to protect itself by asserting the offsets, and had the right to have stockholders of the former corporation substituted as trustees for the creditors to protect the property rights which were a trust fund for the creditors, and the Circuit Court was correct in holding that the right of substitution did exist.

By appropriate proceedings, the rights of creditors, stockholders and other persons interested in corporate assets can be enforced under Rule 25.

This court, in *Bacon v. Robertson*, 59 U.S. 480, 15 L.Ed. 499, held that stockholders of a dissolved corporation had the right to maintain an action against one who had dissipated the assets of the dissolved corporation. Under the laws of the state, the assets which remain after payment of the debts or expenses, belong to the stockholders of the corporation. The court held that the protection of those beneficially interested in the corporation was within the equity powers of the court. The court said:

". . . The power of courts of equity in cases like

these was recognized as adequate to maintain the rights of the parties beneficially interest, and this doctrine was repeated and developed in *Curran v. Arkansas*, 15 How. 304.

> "The tendency of the discussions and judgments of the court of chancery in Great Britain, and of the courts of this country, is to concede the existence of a distinct and positive right of property in the individuals composing the corporation, in its capital and business, which is subject in the main to the management and control of the corporation itself; but that cases may rise where the corporators may assert not only their own rights, but the rights of the corporate body. And no reason can be given why the dissolution of a corporation, whether by judicial sentence or otherwise, whose capital was contributed by shareholders, for a lawful and perhaps laudable enterprise, with the consent of the legislature, should suspend the operation of these principles, or hinder the effective interference of the court of chancery for the preservation of individual rights of property in such a case. . . ."

And the court went on to say of the rights of stockholders:

> ". . . But, if the claims of the creditor are irresistable, those of the stockholder are not inferior, at least against the parties who claim to hold the corporate property. The money, evidences of debt, lands, and personalty acquired by the corporation, were purchased with the capital they lawfully contributed to a legitimate enterprise, conducted under the legislative authority. . . . It is a case, therefore, in which courts of chancery, upon their well-settled principles, would aid the parties to realize the property belonging to the corporation, and compel its application to the satisfaction of the demands which legitimately rest upon it."

In this case the surety, as a creditor, has a right to have its interests protected and the stockholders have a

right to have their interests protected in exactly the same manner as the stockholders were permitted to maintain an action to protect their rights in the case just cited. There was a right in this case for them to be substituted to protect the chose in action which was an important piece of property and to preserve that property for the benefit of the surety company as a creditor.

Under the long-standing rules announced in the case just above quoted, third parties whose rights were affected by the dissolution of the corporation had a right to be protected by the equity powers of the court. The surety is in this position and so are the stockholders. The forms of equity and law were merged by the adoption of Federal Civil Rule 2 and there is no reason at all why the equitable powers of the court should not be applied in this case to protect the surety from the gross miscarriage of justice incident to abating the action of the principal on the main claim and permitting judgment against the surety on the counterclaim.

The reason for Rule 25 permitting substitution could not more clearly be demonstrated than in this case where gross injustice would be prepetrated upon the surety if the chose in action against F. D. Rich Company, Inc., which is its best defense, were permitted to die for the technical reason that the corporate existence of its principal was terminated.

The result arrived at by the Circuit Court in this case was necessary to prevent a gross injustice to the surety.

There is no conflict with laws of Washington and there is no conflict with the decisions of the Tenth Circuit in the cases of *United States v. United States Vanadium Corp.*, 230 F.2d 646, nor *R. V. McGinnis Theatres & Pay*

T. V. Inc. v. Video Independent Theatres, Inc., 386 F.2d 592, which merely held that the law of the state governed the incidents of the corporation.

CONCLUSION

None of the considerations governing review by certiorari, as set out in Rule 19 of this court applies here. The decision of the lower court does not conflict with the decision of any other court of appeals nor with any applicable state law. There is no federal question involved here which has been decided contrary to the decisions of this court, nor is there any showing of any departure from the accepted and usual course of judicial proceedings.

This is not a case in which certiorari should be granted.

Respectfully submitted,

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